SUBMISSION BY THE

CANADIAN LABOUR CONGRESS

TO THE

HOUSE OF COMMONS STANDING COMMITTEE

ON FINANCE AND ECONOMIC AFFAIRS

ON THE

GOVERNMENT WHITE PAPER ON TAX REFORM

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EXECUTIVE SUMMARY

The Canadian Labour Congress commends the current government for endeavouring to expose the highly inequitable and inefficient tax system which exists at present. However, in its overall attempt to devise a more fair and just tax regime, the White Paper on Tax Reform is an abject failure. Under the Government's tax reform proposals neither wealthy individuals nor profitable corporations are required to pay their fair share of taxes.

Any tax system which attempts to generate and redistribute the nation's wealth on an equitable basis must be predicated on the tenets of **fairness, openness** and **simplicity**. Where the White Paper seeks to achieve these goals, as in the conversion of personal income tax deductions and exemptions into credits, the White Paper measures must be applauded.

Taken as a whole, however, the White Paper is not a progressive document. This is due largely to the reduction in the number of personal tax rates and brackets, the increased reliance on consumption taxes, and the underutilization of the corporate tax base.

In generating government revenues, the Congress believes that more reliance should be placed on a personal income tax system underscored by a highly progressive set of rates and brackets. The corporate tax base should be broadened by way of a minimum tax similar to that implemented recently in the United States. Current preferential treatment under the corporate income tax system should be replaced by a system of incentives in the form of direct grants, not through highly unaccountable tax expenditures. Sales taxes, as an inherently regressive measure, should be relied upon less and less. In addition, any future sales tax should be made clearly visible to the consumer at the retail level. Any major adjustment to the tax system should also include the elimination of the existing preferential tax treatment of investment income over employment earnings.

The White Paper proposals will not ensure that fundamental justice is injected into the tax system. Nor will the White Paper entitle Canadians to reduced tax burdens as it promises. The C.L.C. suggests that equity or fairness ought to be the central objective in tax reform. This must be pursued not only for its own sake, but also to ensure that governments have the necessary resources to respond to the need to create full employment and to bring about a meaningful redistribution of income and wealth in Canada.

SUBMISSION BY THE CANADIAN LABOUR CONGRESS TO THE HOUSE OF COMMONS STANDING COMMITTEE ON FINANCE AND ECONOMIC AFFAIRS ON THE GOVERNMENT WHITE PAPER ON TAX REFORM, AUGUST 18, 1987

Mr. Chairman and Members of the Committee:

The Canadian Labour Congress (C.L.C.), Canada's central labour organization representing over two million working men and women, welcomes this opportunity to express its views on the proposals contained in the Government's White Paper on Tax Reform. The issue of taxation, and particularly the way in which the burden of taxation is distributed, is of fundamental concern to all Canadians. Accordingly, we appreciate this Committee's receiving submissions from various groups and organizations on a document of such vital national importance.

As members of the Committee are no doubt aware, the White Paper on Tax Reform raises an incredible number of important issues and includes a vast array of specific proposals. In the time available to us -- and to other organizations -- to prepare our views it has not been possible to deal with all of them in this submission. Therefore we have chosen to limit this formal submission to a general statement of our views of the White Paper that will cover the following points:

First : An overview of the basic principles which guide the C.L.C.'s views on tax reform, namely fairness, openness and simplicity.

Second : A summary analysis of the White Paper in view of the above stated principles.

Third : An outline of the basic features of an alternative tax reform proposal.

It is our hope that in the weeks and months ahead we will be able to address some of the more specific and technical issues in supplementary notes.

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BASIC PRINCIPLES OF TAX REFORM

In recent years, Canadians have become increasingly concerned about the unfairness of Canada's tax system. This concern has focussed on two things in particular: neither wealthy individuals nor profitable corporations are paying their fair share of taxes.

These concerns have a solid foundation to them. In 1983 -- the latest year for which we have data available -- more than 8,000 Canadians reported incomes in excess of $50,000 and paid no personal income tax. In the same year, 110,000 profitable corporations, with total profits of more than $13 billion, paid no corporate income tax.

Like most Canadians we have deep seated concerns about the fairness of Canada's tax system and we have articulated this concern on many occassions over the years. A tax system that is widely viewed as unfair invites tax evasion and avoidance. It undermines the revenue raising capacity of government and the ability of governments to provide essential services. It is grossly unfair to those taxpayers who continue to pay their fair share of taxes.

The strong words of the Carter Royal Commission on this subject bear repeating:

> **"The first and most essential purpose of taxation is to share the burden of the state fairly among all individuals and families. Unless the allocation of the burden is generally accepted as fair, the social and political fabric of a country is weakened and can be destroyed. ...should the burden be thought to be shared inequitably, taxpayers will seek means to evade their taxes. ...We are convinced that scrupulous fairness in taxation must override all other objectives where there is a conflict among objectives.[1]"**

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1. Canada, Report of the Royal Commission on Taxation, (Ottawa: Queen's Printer, 1966)

In our view, fairness has two distinct dimensions to it. First, taxes must be levied on the basis of ability to pay. Those taxpayers with higher incomes must pay a higher portion of their income in taxes than taxpayers with lower incomes. In other words the tax system as a whole must be progressive; it must conform to the principle of **"vertical equity"**.

The second dimension of fairness is that taxpayers with similar incomes and similar family situations should pay similar amounts in taxes. In other words, the tax sytem should conform with the principle of **"horizontal equity"**.

This is not the place to attempt a full-blown critique of the existing tax system and how it fails to conform with the principles of fairness observed above. Nonetheless, certain general points about the existing system should be noted:

1) the personal income tax (P.I.T.) is the only existing tax which has the capacity to be clearly progressive because of its schedule of tax rates that increase with income;

2) the P.I.T. is not progressive enough to offset the regressive effects of other taxes at the federal and provincial/municipal level -- especially sales taxes;

3) the progressiveness of the existing P.I.T. is limited by:

    a) a relatively flat rate structure that imposes its highest rates at a level of taxable income that is less than 2.5 times the average wage and salary;

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b) the widespread use of exemptions and deductions in the P.I.T. which are relatively less progressive than credits;

c) the existence of a number of preferences in the P.I.T. that give it a systematic bias in favour of investment income versus employment income, and income that is saved versus income that is spent on goods and services (ie. consumed);

4) the preferences given to investment income also violate the principle of horizontal equity; a given amount of investment income is always taxed less heavily than the same amount of employment income.

In concluding these observations on fairness it is important to say something about the role of the corporate income tax (C.I.T.). We have already described the P.I.T. as a basically progressive tax and sales taxes as inherently regressive. Yet because of the prevailing confusion as to whether the corporate income tax is borne by consumers or by corporate shareholders, we acknowledge that the C.I.T. does not fit tidily into the progressive/regressive distinction. Nonetheless, in the absence of sweeping changes that would fully integrate the personal and corporate tax bases, we belive that it is important to fully utilize the corporate tax base. If this is not done then there will be inevitable and unnecessary downward pressure on government's ability to provide necessary services and income protection for Canadians. Moreover, in so far as the actual burden of the C.I.T. falls on shareholders, it is a highly progressive tax. Finally, even in relation to the alternative of a completely integrated personal and corporate tax system, the C.I.T. has the virtue that it taxes foreign shareholders and raises some revenues from otherwise non-taxpaying entities.

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A second principle that is of great importance is the principle of **"openness"** in the tax system. Again, this principle has two aspects to it.

In the first place the real tax burden faced by taxpayers and changes to the real tax burden they face should be clearly visible. In this regard, the federal manufacturers' sales tax (M.S.T.) and the other sales and excise taxes imposed by the federal government have been a longstanding source of a lack of visibility. By and large, the consumers who are paying the taxes don't know they are paying them. Another source of difficulty in this regard is the recent decision of the current government to replace the full indexation of exemptions and brackets under the P.I.T. with an arrangement whereby exemptions and brackets are indexed only to annual inflation minus three per cent. This change in indexing arrangements has produced substantial increases in the real P.I.T. burdens faced by taxpayers without the government's having to seek Parliamentary approval for the increase.

There is, however, a second aspect to the openness issue that is of great concern to us and that is the lack of adequate reporting by, and accountability of, the government for the use of selective tax measures. Since the early 1970's, there has been a substantial increase in the use of preferences and incentives in the personal and corporate income tax. Many of these incentives have been rationalized as ways of creating employment by stimulating savings and investment and the use of these selective measures has received particular impetus thanks to the government's commitment to direct expenditure restraint in the mid-1970's.

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The fiscal importance of these selective measures is substantial. In one of his recent reports, the Auditor General estimated that for every $100 that the federal government collects in tax revenues, it gives up $30 to $50 in selective tax measures. In spite of the fiscal importance of these measures, there is no formalized basis for reporting to Parliament and the Canadian public on the amounts of revenue foregone as a result of these measures. While the government has produced estimates from time to time on revenues foregone in the form of tax expenditure accounts, only one of these even broached the subject of their use by taxpayers at different levels of income and none has evaluated their effectiveness in meeting their stated objectives.

The C.L.C. views this as a totally unsatisfactory state of affairs. The limited evidence that does exist suggests that the selective measures in the P.I.T. reduce its progressiveness and its horizontal equity. Moreover, there are strong grounds for being skeptical about the effectiveness of the selective measures in the corporate income tax (C.I.T.) in increasing employment. In view of the lack of regular and formal reporting on these matters, there is little or no accountability on the part of the government -- or corporate or personal taxpayers -- for how these selective measures are used.

Finally, we should note a third principle that is important to our assessment of both the existing tax system and the White Paper proposals: that is the principle of simplicity. As far as possible, the tax system should be readily understandable to all taxpayers.

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Without wishing to dwell at length on the issue of simplicity, there are certain general points worth making. The first is that within all major components of the tax system, the primary source of complexity stems from the bewildering array of special exemptions, deductions and credits; the rate structures themselves are not a major source of confusion. Thus, the major sources of complexity tend to be the same features of the tax system that limit its progressiveness and its horizontal equity -- especially within the P.I.T.. Moreover, within the P.I.T. it is also the case that certain exemptions and deductions that are designed to serve social objectives (eg. aged and child exemptions) not only add to the complexity of the tax system but also confuse the manner in which the government offers income support to various target groups. Finally, within the C.I.T., a major source of complexity is the vast array of preferences -- the effectiveness of which is shielded from view by the lack of openness discussed above. In short, while simplicity is an important issue in itself, in the current Canadian context it is intimately linked to the other issues of fairness and openness.

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SUMMARY ANALYSIS OF THE WHITE PAPER PROPOSALS

As was noted above, our primary concern with the existing tax system -- and one which we share with most Canadians -- is its manifest unfairness. In its most dramatic form, this unfairness is revealed in high income individuals paying no personal income taxes and profitable corporations paying no corporate income tax. One would have hoped that these situations would have been made impossible by the White Paper proposals. Unfortunately the White Paper does not accomplish even this limited objective.

As far as high income individuals are concerned, the new rules governing the tax treatment of investment income will reduce, by degree, the likelihood of high income taxpayers being able to avoid paying taxes. Nonetheless, the possibility still exists for some high income taxpayers to pay no P.I.T. -- mainly because of the **"revised"** capital gains exemption and the right of taxpayers to deduct carrying charges on loans taken for investment purposes.

As far as corporate taxpayers are concerned, the White Paper estimates that had the C.I.T. reform proposals been in place in 1983, 60,000 out of the 110,000 profitable corporations that paid no C.I.T. that year would still have paid no corporate income taxes.

A glancing, somewhat half-hearted blow has been dealt to the most obvious manifestations of a patently unfair tax system.

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If one looks beyond the most obvious manifestations of unfairness, a more general fairness question arises. Do the reform proposals in the White Paper increase the percentage of income that high income taxpayers will pay in taxes compared to the percentage of income that low income taxpayers will pay? In other words, are the changes progressive; are they based on ability to pay? The short answer to this question is that the changes are not progressive and the reason for this is not hard to find.

The White Paper includes estimates of the effects of its P.I.T. reform proposals on taxpayers in different income classes. These estimates compare personal income taxes in 1988 before and after reform and include a measure of changes in P.I.T. owing as a percentage of income, which is the most appropriate measure of progressiveness. (See Table below.) As can be seen from the table, the reforms to the P.I.T. have an almost equal impact on the percentage of income that all groups will pay in personal income taxes. In short, the P.I.T. reforms are almost neutral with regard to the distribution of P.I.T. burdens among income groups.

Overall Impact on Family Units Aged 65 and Over: Change in Federal/Provincial Personal Income Tax, 1988

Income range	Number affected	Average change	Change as a per cent of tax	Change as a per cent of income
($000)	(000)	($)	(%)	(%)
Under 15	405	−160	−35.4	−0.9
15–30	605	−350	−16.6	−1.6
30–50	265	−265	−4.4	−0.7
50–100	115	−165	−1.2	−0.2
100 and over	35	−1,465	−2.6	−0.8
Total	1,425	−290	−6.3	−0.9

Source: Income Tax Reform, p.38, from Tax Reform Documents, Dept. of Finance, June 1987

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But, while the P.I.T. burdens are distributionally netural by themselves, they are coupled with proposals for immediate sales tax increases that amount to more than $1 billion per year and proposals for a Stage II sales tax reform that will increase sales tax revenues by at least an additional $3 billion per year. These proposed increases in sales tax revenues are also coupled with proposals to increase the refundable sales tax credit which will protect some low income taxpayers against the effect of the sales tax increases. Nevertheless, sales taxes remain inherently regressive taxes. When sales taxes are coupled with an increase in the refundable sales tax credits, all we do is to increase the income level at which the regressive pattern of these taxes sets in. The refundable sales tax notwithstanding, the point remains that a neutral set of changes in the P.I.T., when coupled with an increase in sales taxes, results in a set of proposals that are regressive overall.

Because the progressiveness of the personal income tax is absolutely vital to the progressiveness of the tax system as a whole, it is worth dwelling for a moment on why the proposed changes to the P.I.T. are distributionally neutral. In this regard we can begin by noting that there are three major sets of proposed changes that affect the progressiveness of the P.I.T.:

1) The conversion of exemptions and some deductions into non-refundable credits which, in itself, is progressive;

2) Increased taxation of investment income (ie. changes to the dividend tax credit; the taxation of capital gains, and the elimination of the investment income deduction) which, in itself, is progressive;

3) The introduction of a new rate structure which raises the rates of taxation on the lowest levels of taxable income from 6 to 17 per cent and lowers the highest rates of taxation from 34 to 29 per cent and is therefore regressive.

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Obviously, the neutral overall effect of the P.I.T. changes that is documented in the above Table reflects the cancelling out of the progressive effects of the first two sets of changes by the regressive effect of the change to the rate structure. Indeed, this cancelling effect is so close to being perfectly exact that one is left to wonder whether distributional neutrality was not a guiding principle in designing the P.I.T. changes.

Before leaving the question of the White Paper's contribution -- or lack of it -- to the progressiveness of the tax system, there are several issues that should be noted in this context even though they are somewhat distinct from the issue of progressiveness as defined above. These issues include the following:

- under the White Paper proposals, people with very low incomes are protected against the need to pay personal income taxes through the availability of non-refundable credits; yet because these credits are not fully indexed, the real value of this protection will decline at the rate of 3 per cent per year and an increasing number of low income Canadians will face the need to pay personal income taxes in the years ahead;

- because various features of the tax system are dealt with in isolation from each other and from income security programs, there is a real possibility that some low income groups will face very high effective marginal tax rates that will reflect, for example, the tax back rates under income tested direct transfer programs; the rates of reduction under income tested refundable tax credits and; positive marginal tax rates under the P.I.T.;

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- because the primary source of minimum income protection for Canadians under 65 is provincial social assistance programs, any attempt to improve the lot of low-income Canadians through the use of refundable or non-refundable tax credits must be coupled with the striking of an agreement with the provinces that increased credits will not be used as an excuse to curtail provincial social assistance payments; and finally,

- it is worth noting that non-refundable credits which are to become an important part of the P.I.T. have the same distributional effect as universal flat rate payments except at the very low end of the income scale where the universal payments are of greater value.

As we noted in the previous section of this submission, the question of fairness has two dimensions to it. We have already looked at the White Paper proposals in terms of our concerns about progressiveness -- or vertical equity -- and we have found them wanting. Unfortunately the same must be said about our concern with horizontal equity -- the principle that people with similar incomes and similar family situations should be taxed in a similar fashion.

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With regard to horizontal equity, our major concern is with the preferred treatment of investment income versus other forms of income -- particularly employment income. It is true, of course, that the White Paper includes: a reduction in the dividend gross-up and tax credit; a minor retreat from the Finance Minister's proposal to exempt the first $500,000 of lifetime capital gains from taxation, as well as an increase from 50 to 75 per cent of the amount of capital gains to be included in income; and finally, the elimination of the investment income deduction. With a rather important qualifier that we will note below, we can endorse the direction in which these changes move the Canadian tax system. However, the crucial question that requires an answer is this: when these changes are fully implemented, will investment income be taxed in the same way as employment income? Unfortunately the answer is still a resounding **no**. Investment income will still receive substantially preferential treatment. According to our calculations, a person receiving $40,000 in investment income in 1988 under the new rules ($10,000 in capital gains and $30,000 in dividend income) would owe $1,252.24 in federal P.I.T. compared to $5,702.70 that would be owed by someone with $40,000 employment income. This compares with $544.80 and $7,041.32 resprectively, under the existing rules. We are still a long way from the world of the Carter Royal Commission in which a **"buck is a buck"**. To put a somewhat finer point on this, we do not believe that people who can earn their investment income lying on the beach in a tropical resort are making a greater contribution to the Canadian economy than are our members who show up daily at work and are paid wages and salaries for producing goods and services.

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Several further points about the tax treatment of investment income under the White Paper proposals should not pass without comment:

- The preferential treatment of investment income versus employment income arises not only at the time that the income is received but also in terms of the tax treatment of the costs incurred in earning it. Under existing rules the cost incurred in earning employment income are limited to the $500 employment expense deduction which the White Paper proposes to eliminate, whereas the carrying costs incurred in **"earning"** investment income are fully deductible under the existing and proposed regimes.

- The combined federal and provincial value of the proposed devidend tax credit will still exceed what can be justified by concerns about the double taxation of corporate profits -- even if it is assumed that the full burden of the C.I.T. is borne by shareholders.

- By comparison with the dividend tax credit and the limited taxation of capital gains, the investment income deduction is much more widely used by people with moderate to low incomes and appears to be of particular importance to those people approaching and/or over 65. The impact of of its elimination on these age groups merits particular attention. This was probably the last place to insist that a **"buck is a buck"**.

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- On several occassions since May, 1985, we have advised the current Minister of Finance that his proposals for the tax treatment of R.R.S.P.'s and pension plans are regressive; they cost the public purse an unnecessary amount of foregone tax revenue; they are unfair in intergenerational terms; and they create unnecessary complications for negotiating improvements to group pension plans. These general propositions remain valid despite the White Paper proposal to slow down the rate at which they are implemented.

Within the tax system itself, our chief concern with regard to horizontal equity relates to the treatment of employment income versus investment income. However, there is another horizontal equity issue that is affected by a White Paper proposal that must not pass unnoticed. We are referring here to the treatment of families with children versus those without children under our tax and transfer system.

The White Paper includes a proposal to convert the existing tax deduction for dependent children which has an estimated value of $388 in 1988 to a non-refundable credit of $54 and limit the availability of the credit to children 18 and under. In itself the conversion of the deduction to a credit is a progressive move -- although low income families with children would derive a greater benefit from an increase in Family Allowance payments which have the same distributional properties as non-refundable credits for higher income groups. However, the new credit will only be indexed to the rate of annual inflation minus three per cent. This partial indexing arrangement has already been applied to Family Allowance benefits and will also be applied to the amount of the exisiting Child Tax Credit and the income level up to which the full Child Tax Credit is paid. In short, all major components of the tax and transfer system that are designed to provide horizontal equity between families with and without children will have their real value undermined at the rate of three per cent per year. The Congress views the Government's decision to undermine the real value of these benefits as totally unacceptable.

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If the White Paper makes a negative contribution to the progressiveness of the tax system as a whole and an all too limited contribution to the horizontal equity of the P.I.T. it deals with the issues related to the principle of openness largely by ignoring them. With the benefit of hindsight this may not be hard to understand. It is striking that in articulating the principles that would guide tax reform in the **"Guidelines for Tax Reform"** which the Finance Minister tabled in the House of Commons in October, 1985, no mention was made of the issues that we have raised under the principle of openness. This is particularly unfortunate.

In looking at the White Paper proposals themselves, there are two features of them that are particularly offensive to our concern about the need for tax burdens and changes in them to be highly visible. The first is the refusal to restore the full indexation of the remaining tax brackets and to apply the principle of full indexation to the proposed tax credits. The second is the increase in the Stage I sales tax revenues with no regard shown for visability and the proposed increase in the Stage II sales tax revenues with minimal regard being shown for visability.

Just as offensive to our concern with openness is the fact that the White Paper does not address the issue of the lack of government reporting on and accountability for its use of selective tax measures. Indeed it is somewhat remarkable -- even disingenuous -- to present a White Paper that proposes to reduce or eliminate a number of tax preferences but says nothing of the need for regular and consistent reporting on such matters as: the annual revenue cost of various selective tax measures; the use of various selective measures by different groups of personal and corporate taxpayers; and the effectiveness of selective tax measures in meeting their stated objectives. It seems to us that this type of reporting is required not only by the principle of openness, but it is also required to establish the credibility of the White Paper itself.

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Indeed, the White Paper is hardly a shining example of openness. Many of the most important questions about the impact of White Paper proposals are well concealed from view. For instance, listed below are some very important questions to which no answer can be found in any of the documents tabled with the White Paper:

- What is the combined distributional effect of the proposed changes to the P.I.T. and federal sales taxes in Stage I and Stage II?

- How has the P.I.T. and the total tax burden of various income groups changed since 1984 when the current government took office and how will it change in the future in view of the partial indexation of the proposed credits and rate brackets? (This question becomes particularly relevant in view of the claim that the White Paper reforms reduce total P.I.T. burdens by $2.5 billion per year and remove 800,000 low income Canadians from the P.I.T. rolls. In context, it is worth noting that a 1986 budget document estimates that changes to the P.I.T. introduced by the current Finance Minister will increase P.I.T. revenues by $4.3 billion by 1990!)

- What are the separate affects on the revenue raising capacity of the P.I.T. and its distributional effect of 1) converting exemptions and some deductions to credits; and 2) the changes to the rate structure?

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- With regard to the corporate income tax:

  - how does the estimated revenue impact of the C.I.T. changes compare to the total revenues foregone as a result of selective tax measures?

  - what are the effective tax rates faced by corporations of different sizes and different degrees of capital intensity under the existing and proposed rules?

  - how do the existing and proposed rules affect the degree of concentration of ownership of the corporate sector?

  - if it is reasonable to reduce or eliminate certain tax preferences in the C.I.T., what are the most appropriate forms of government support for the business sector.

These are not small questions and admittedly some of them extend well beyond the tax system itself -- particularly those related to the C.I.T.. Yet the White Paper cannot be read in a critical fashion without confronting these and many more important questions for which no answer will be found in the White Paper and the supporting documents that were tabled with it. As was noted above, the White Paper itself is not a glowing model for openness with regard to the public discussion of tax issues.

As we noted in the previous section of our submission, a lack of openness has an inevitable partner -- a lack of accountability. In this regard the White Paper is no exception to the rule.

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Despite all of the claims of the White Paper to be responding -- in an accountable fashion -- to the justifiable concerns of Canadians about the fairness of our tax system, this does not appear to be the pre-eminent concern that has shaped the White Paper proposals. If one concern has had an overwhelming impact on the White Paper proposals it is the desire to make Canada's tax system look like the one recently brought into being as a result of the tax reform in the United States. In our view it is no accident that the basic C.I.T. rate proposed in the White Paper and the top marginal tax rate under the P.I.T. are virtually identical to those that result from tax reform in the U.S.. Moreover, having decided to cap these rates at the U.S. levels, we also believe that there was no choice but to attempt to broaden the tax base of both the C.I.T. and the P.I.T. by reducing or eliminating certain selective tax measures - otherwise neither the C.I.T. nor the P.I.T. would have raised enough revenue.

Yet not only was the substance of the White Paper reforms shaped by the U.S. agenda, so was (and is) the timing. In February, 1986 when the Finance Minister presented his budget, comprehensive tax reform was not a major issue. In the summer of 1986 -- by which time the U.S. Congress had passed a tax reform bill -- it was. Now the C.L.C., like many groups in Canada, find ourselves scrambling to keep pace with a legislative agenda that foresees implementation of Stage I of tax reform by January 1, 1988, so that Canada can be **"on course"** with the United States.

As we are sure members of the Committee can appreciate, there is an inevitable dissatisfaction that stems from having to deal with an incredibly important issue in a time frame that is unduly compressed. (In context it is worth noting that five years elapsed between the publication of the Carter Royal Commission Report and the announcement of resulting changes to our tax system.) However, our dissatisfaction is accentuated to the point of acute aggravation when we realize that the unseemly haste with which the current government is proceeding with tax reform is being determined by the pending introduction of new tax laws in a foreign country.

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In raising this point about the degree to which the White Paper proposals reflect the tax reform initiatives in the U.S., there are two points concerning the proposals themselves and three more general points that are in particular need of underscoring. First, with regard to the proposals themselves:

1) The perceived need to limit the top marginal P.I.T. rate in Canada to the top marginal P.I.T. rate in the U.S. has severely limited the progressiveness of the P.I.T. itself and, more importantly, the tax system as a whole.

2) The decision to link the general Canadian C.I.T. rate to that in the U.S. has severely limited the revenue raising capacity of the Canadian C.I.T.. The White Paper estimates that reduced C.I.T. rates will cost the federal government $1,890 million by 1992.

At a more general level we can note the following:

1) Making the Canadian P.I.T. and C.I.T. similar to the U.S. P.I.T. and C.I.T. is part of the same process of levelling the business playing field between the two countries in preparation for a comprehensive free trade pact, as are such initiatives as deregulation and privatization.

2) It is also true that other Canadian governments since the end of World War II have shaped their tax policy recommendations with a view to making the Canadian tax system similar to that in the U.S.. For example, making the Canadian tax system comparable to the U.S. tax system had a great deal to do with former governments rejecting the major recommendations of the Carter Royal Commission and the introduction of the two year write-off of machinery and equipment in the manufacturing sector.

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3) As these various episodes in equalizing the tax situation in Canada and the U.S. have been played out, there are two critically important things that have never been done: first, successive governments have never offered the Canadian public reasonable empirical estimates of the extent to which they would suffer economic losses if the Canadian tax system placed greater emphasis on fairness than did the U.S. tax system; second and more importantly, Canadians have not been offered the choice of a fairer tax system but maybe a **"less competitive"** tax system, with its possible economic cost -- than the U.S. system.

Our view on the similarity of the Canadian and U.S. tax reform proposals may be viewed by some people as needlessly polemical. In our view they are not. The progressiveness of the P.I.T. and the revenue raising capacity of the C.I.T. have been severely limited by the desire to mimic tax reform in the U.S.. These are such important negative features of the White Paper proposals that the onus of proof shifts from groups like ours to the government. It is incumbent on the government to demonstrate what a Canadian tax system that places greater emphasis on fairness than does the U.S. tax system will cost in economic terms and, further, to show that this will conflict with what Canadians want. We have raised this issue under the general heading of accountability because we believe that the process of modelling the Canadian tax system on that in the U.S. defies the concept that the Canadian government should be responsible and accountable to the Canadian public primarily for the fairness of the Canadian tax system. This is the main concern that Canadians have in demanding change in the tax system and yet it is a concern that is sacrificed in large measure due to a desire to keep our tax system similar to that in the U.S..

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With regard to the principle of simplicity, what is most immediately striking about the White Paper proposals is how little is accomplished in terms of simplifying the personal income tax. Virtually all of the existing exemptions and deductions remain intact -- either in the form of non-refundable credits or in the form of deductions. The only notable exceptions to this rule are the employment expense and investment income deductions which have been eliminated altogether. Unfortunately, these strike us as rather poor places to begin the process of simplification for reasons noted above. These two exceptions notwithstanding, taxpayers will have to get used to new tax return forms that are not likely to be any simpler or easier to understand than the current ones.

It seems to us that one of the reasons why so little progress is being made in simplifying the P.I.T. is because the various provisions of the P.I.T. are being considered in isolation from direct expenditure programs. As a result, the possibility of simplifying the tax system by rolling tax provisions into direct expenditure programs has not been recommended. Two **"social measures"** provide particularly striking examples of the opportunities that have not been considered. The White Paper proposes to convert both the exemption for dependent children and the aged exemption into non-refundable credits. For the target groups of each of these tax measures we have universal flat rate direct expenditure programs -- namely Family Allowances and Old Age Security. In each case the universal flat rate program has the same distributional properties as the proposed credits except at low income levels where the universal payments are worth more because of the **"non-refundable"** nature of the credits. It is difficult to understand why the White Paper did not recommend rolling the relevant tax measures into the direct expenditure programs unless the tax measures were dealt with in total isolation from related direct expenditure measures. It is worth noting, too, that rolling tax measures into direct expenditure programs would simplify the income support system as well as the tax system.

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We have no firm view on whether the C.I.T. changes referred to in the White Paper make the C.I.T. more or less complex than it is at present. However, we are struck by the fact that the White Paper proposals make a number of changes to existing tax preferences for corporations without addressing more basic questions about the most appropriate ways for the government to offer support to the business sector. For many years, the C.L.C. has argued that as a general rule, support for individual businesses should be provided primarily by direct grants that are tied to performance guarantees rather than tax incentives. While our main reasons for arguing this way relate to the effectiveness of, and accountability for support, another by-product of switching to this form of support would be to simplify the C.I.T.. Again, the White Paper ignores this possible source of simplification of the C.I.T..

Finally, as far as the sales tax is concerned, we would simply note the following with regard to simplicity and the Stage II reforms. The White Paper presents three options for Stage II reform, all of which are variants on a value added or "multi-stage" tax. The White Paper is also quite clear on the point that the ultimate burden of these taxes will be passed on to the consumer at the retail level. Ignoring other aspects of the options presented by the White Paper, we are struck by the fact that each of the variants on the multi-stage tax involves a degree of administrative burden at each stage in the production process. Given this -- and given that retailers will be the ultimate tax collectors from the consumer -- concerns about simplicity would suggest that the option of a national retail sales tax should be considered. This option might also contribute to a greater visibility of the tax.

In concluding this summary analysis of the White Paper, we will comment on the proposed changes to the Corporate Income Tax. Once again the concerns that we wish to raise in this area do not fit tidily under the principles that we have used to organize our comments thus far. In addition, we feel obliged to put an important caveat on what follows. The proposed changes to the C.I.T. and the analysis of them in the White Paper are less helpful in coming to grips with the issues of concern to us than is the case with the other parts of the White Paper proposals.

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Bearing that caveat in mind we will organize our comments around three interrelated issues:

- the underutilization of the corporate tax base;
- the use of selective corporate tax measures;
- the role of the corporate tax system in encouraging the concentration of ownership

With regard to these issues it is worth noting that the White Paper addresses the underutilization of the corporate tax to a degree, by presenting a package of proposals that are designed to increase C.I.T. revenues. The White Paper addresses the issue of selective tax measures in a rather piecemeal way by reducing or eliminating some of them but does not deal in general with their role in the C.I.T., their effectiveness, their accountability problems or the alternatives to the use of selective measures. Finally, the White Paper totally ignores the question of the relationship between the C.I.T. and corporate concentration.

The failure to discuss the relationship between the C.I.T. and corporate concentration might have been forgivable had the issue never been raised before. It might also have been forgivable if the political process afforded regular opportunities to review and deal with the issue. Unfortunately neither of these conditions applies. Thus,the failure to address this issue in the White Paper is a major shortcoming in its treatment of the C.I.T..

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Given the absence of relevant data in the White Paper and the limited time available to us to prepare this submission, we are not in a position to take a definitive stance on the the contribution of the C.I.T. to corporate concentration. Nonetheless, we would hope that before the Committee has completed its deliberations, it would investigate this issue throughly. Among the specific things that should be looked at are:

- the extent to which selective corporate tax measures are used by very large versus smaller firms and the extent to which this provides them with lower effective C.I.T. rates and facilitates more rapid internal growth of larger firms;

- the extent to which takeovers and mergers are facilitated by the following features of the C.I.T.:

  1) the fact that capital gains are not deemed to be realized when mergers are financed through share for share exchanges;

  2) the fact that interest payments on loans to finance takeovers and mergers are tax deductable;

  3) the generous provisions for carrying tax losses forward and backward and the right of new owners of corporations to effectively buy tax losses through mergers and takeovers.

- the extent to which conglomerate corporate structures are encouraged by the right to apply tax losses in one line of business against taxable profits in another.

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In suggesting that the Committee look into these issues, we are not in a position to identify precisely the contribution that any of them makes to corporate concentration in Canada. Nonetheless, **"the logic of the situation"** suggests that they are at least worthy of investigation. In addition, while we have noted above that C.I.T. issues do not fit neatly into an analysis of the progressiveness of the tax system, we are very concerned that the concentration of corporate ownership in Canada is contributing to the control of an increasing portion of Canada's wealth in a very few hands.

We have noted above that the White Paper does not include a direct discussion in principle of the role of selective tax measures in the C.I.T. and, as a result, it leaves unanswered the general question of the appropriate use of selective tax measures versus other forms of support. There is no need to pursue this specific point any further at this juncture. However, it should be noted that this issue is linked to the other two issues we have raised concerning the C.I.T.. To the extent that the selective tax measures are being more fully utilized by larger firms, they may be contributing to corporate concentration. Moreover, they are limiting the revenue raising capacity of the C.I.T.. As the White Paper observes, the average effective C.I.T. rate faced by profitable corporations prior to reform is only 18.7 per cent despite a basic statutory rate of 36 per cent; it is also noted that in 1983, 110,000 profitable corporations paid no C.I.T. at all.

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For the C.L.C. one of the crucial questions that arises about the C.I.T. reform proposals is whether they fully utilize the corporate tax base. In this context it is worth noting that the C.I.T. reforms include a broadening of the C.I.T. base through the elimination and reduction of certain selective tax measures and the lowering of C.I.T. rates. The White Paper includes an estimate that by 1992, the base broadening features of the C.I.T. reforms will increase C.I.T. revenues by $3,450 million while the rate reductions will cost $1,890 million in foregone revenues. On balance C.I.T. revenues will increase by $1,580. At the same time it is striking that the attempt at base broadening has been very selective in the sense that a limited number of measures have been targetted for elimination or reductions. Thus, of the $3,450 million increase in revenues resulting from base broadening measures, $2,220 results from two sets of changes: measures affecting the finance, insurance and real estate sectors -- $1,150 million; and new rules governing the capital cost allowance -- $1,070 million.

What results from the White Paper reforms to the C.I.T. would appear to be a far cry from the full utilization of the corporate tax base. In one sense this fact is graphically documented in the White Paper where it is noted that 60,000 out of 110,000 profitable corporations that paid no C.I.T. under the existing rules would have paid no tax under the reformed rules. Ideally, one would be able to compare the revenue increases attributable to the base broadening measures with the total cost of selective C.I.T. measures in order to assess the degree to which the base broadening measures eliminate C.I.T. preferences. Unfortunately, the White Paper does not provide the data to permit such a comparison and we have not had time to prepare one. But it is suggestive to note that the Department of Finance estimated that by 1981 the ability of corporations to claim Capital Cost Allowances in excess of book depreciation was costing the federal government between $1,726 million and $2,216 million in foregone C.I.T. revenues annually. This is nearly double the 1992 estimate of the revenue gains that are predicted to result from the revised C.C.A. rules. In short, we are left with the distinct impression that there is still a great deal of ground that can be covered in terms of broadening the corporate tax base.

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We are also skeptical about the need to compensate corporate taxpayers for having broadened the C.I.T. base with a reduction in C.I.T. rates. With regard to this point, it should be noted, first of all, that the lowering of rates reduces the potential increase in C.I.T. revenues from $3,450 million in 1992 to $1,580 million. Second, because firms in a number of industries have been paying something close to the full statutory C.I.T. rates, it is hard to accept the idea that the existing statutory rates are themselves too burdensome. Indeed, it would appear that the only clear reason for lowering the statutory C.I.T. rate is to maintain parallelism with the U.S.. But, as we said above, the burden of proof with regard to the need to maintain a uniformity with the U.S. tax system lies with the government. We know that substantial C.I.T. revenues are being lost by lowering C.I.T. rates to U.S. levels. It remains to be demonstrated by the government that this is necessary and in keeping with the broad wishes of Canadians.

We also wish to register our strong opposition to corporations incurring deferred taxes under existing C.I.T. rates and then being allowed to pay them under the new proposed rates. As far as we are concerned, accumulated deferred taxes should be paid at existing rates; corporations with accumulated deferred taxes should not derive a windfall gain out of tax reform.

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BASIC ELEMENTS IN AN ALTERNATIVE APPROACH TO TAX REFORM

In the course of expressing our views on the White Paper, our own views on how the tax system should be reformed have been implied in many passages; our critical comments on the White Paper flow naturally from our own views. In this section we will briefly summarize the positive perspectives on which our critical comments in the previous section are based. It is our hope that in summarizing these positive perspectives, the nature of tax reform that emphasizes fairness, openness and simplicity will be clarified.

In the reforms proposed in the White Paper, one of the objectives to be accomplished is to rebalance the sources of federal government tax revenues. Personal income taxes are to be cut and corporate and sales taxes are to be increased. There may be as much illusion as reality to this rebalancing, but the rebalancing is the stated objective. Moreover, this rebalancing is to be done in a revenue neutral way. The revised system is supposed to raise similar amounts of revenue to the exisiting system.

From our point of view the question of balance must be approached with fairness in mind. We know that the only existing tax that has the clear capacity to be progressive is the personal income tax; the C.I.T. is somewhat unclear in terms of its progressiveness and sales taxes are clearly regressive. Therefore, if the tax system as a whole is going to be progressive then the personal income tax must be strongly progressive in order to offset the effects of other taxes. In addition, the P.I.T. will have to be a pre-eminent source of tax revenues so that the need to rely on sales taxes is limited. Indeed, one of the basic rules of a tax reform exercise that emphasizes fairness would be that there be no increase in sales taxes.

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Again, as we suggested in the previous section, we would like to be certain that the corporate income tax base is fully utilized as a source of tax revenue and the White Paper proposals do not accomplish this objective. Had the corporate tax base been fully utilized, the progressiveness of the P.I.T. at the low end of the income scale could have been enhanced and the need for sales tax increases diminished.

In the current Canadian context it is also doubtful whether fairness demands a revenue neutral package of reforms. As we have noted on many occassions in this submission, Canadians are primarily concerened about the fact that many high income individuals and profitable corporations are not paying their fair share of taxes. Canadians want these taxpayers to pay up. By itself, meeting this objective would increase the fairness of the tax system and increase government revenues.

We will not dwell on this issue at great length but there are several related points that should be made. First, total tax revenues in Canada as a percentage of Gross Domestic Product are somewhat below average for the industrialized world. Second, we still have substantial unmet needs in the social service and income support areas. Third, we note that the current government feels no need to be expenditure neutral when it is cutting expenditures; in other words, when it cuts expenditures in one area it feels no obligation to increase them somewhere else. If neutrality is not demanded on one side of the budget, why is it demanded on the other?

Before leaving the question of revenue balance, there is one further point we wish to raise. It was noted above that the P.I.T. is the only existing tax that is clearly progressive. However, it should also be noted that Canada is one of the few industrialized countries that imposes no national taxes on wealth. In our view wealth reflects an ability to pay taxes and it is, by its nature, a potentially progressive tax base. Tax reform that emphasizes fairness would consider taxing wealth above a moderate threshold level.

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The White Paper makes a great start at improving the fairness of the P.I.T. by converting exemptions and some deductions into credits. Our main concerns with the credits, as proposed, are that they leave many people with poverty level incomes paying P.I.T. and the credits have not been extended to R.R.S.P. and pension contributions. With regard to the latter point we would note that for people with low earnings, the tax deductibility of contributions is of little value and the net value of their retirement savings will be cut in half if their retirement incomes are below the level at which the Guaranteed Income Supplement ceases to be paid. In short, there is little incentive to save for retirement. Having said that, we would point out that increased Canada and Quebec Pension Plan benefits should be the primary way of providing adequate retirement incomes to people with moderate and low incomes.

Unfortunately, the progressive effect of the new credits on the P.I.T. is totally undermined by the new rate structure proposed in the White Paper. If fairness had dictated the revisions to the rate structure, the priority would not have been placed on reducing the number of rate brackets and levelling the rates. Instead, priority would have been placed on introducing new and higher rates at the top end of the income scale. When senior corporate executives are being paid salaries of more than ten times the average wage and salary, we see absolutely no reason why the top marginal tax rate should be applied at a level of taxable income that is just over twice the average wage and salary. The White Paper perpetuates a discouraging trend in the reform of Canada's tax system to lower both the top marginal P.I.T. rates and the level of income to which they apply; these were also features of the Benson reforms of 1971 and the MacEachen reforms of 1981. The only P.I.T. rates that should be lowered are those at the moderate to low end of the income scale.

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Reform of the P.I.T. with fairness in mind must also eliminate the unequal treatment of employment versus investment income. The P.I.T. must deal with all income on the basis that **"a buck is a buck"**. In order to move in this direction, 100 per cent of capital gains should be taxed without exemption and the dividend tax credit should meet one of the following fates:

1) it should be eliminated;

2) it should be eliminated and all corporate profits should be attributed to shareholders and taxed as personal income (note caveat above p.23);

3) the combined federal provincial value of the credit should be reduced to one half of the average effective C.I.T. rate on the assumption that half the C.I.T. is shifted forward to consumers;

4) the credit received for dividends received from individual corporations would be half of the C.I.T. rate of each corporation.

In addition, the P.I.T. must deal with costs incurred in deriving employment versus investment income in an even-handed way. The White Paper proposal to eliminate the employment expense deduction while still permitting the open-ended deduction of the carrying costs incurred in **"earning"** investment income is unacceptable.

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Within the C.I.T. we have already noted that fairness demands the full utilization of the corporate tax base. However, like most Canadians, we also believe that fairness demands that all profitable corporations pay some corporate income taxes. One way to achieve this objective would be to remove all selective measures from the C.I.T. and replace them with grant programs. As the Carter Commission noted, this approach certainly has merit as a way of enhancing the openness and accountability of government support for particular businesses. In the immediate future, however, this approach is probably hard to apply on a comprehensive basis. Therefore, the alternative of a minimum corporate tax is probably the only option open at the present time. In context, we note with dismay that this is one key feature of tax reform in the U.S. that is not supported in the White Paper.

In addition, it is important to note once again our concerns about the relationship among the C.I.T., the concentration of corporate ownership, and the accumulation of wealth in a small number of hands. A tax reform exercise that was guided by concerns about fairness would not have ignored this issue.

We have already noted above that fairness would dictate that there be no increase in federal sales tax revenues. However, we also want to state our strong opposition to the taxation of essential goods and services -- and especially food. In taking this position we are mindful of the strong argument that the government has made for a comprehensive sales tax base and we also share the governments' view that the existing Manufacturers Sales Tax is outdated. Having acknowledged that, we are equally mindful of both the chaotic, miserly and stigmatizing arrangements that are now in place for providing minimum income protection for Canadians under 65, and of the incredible extent to which poverty has increased in recent years in Canada. Under the current circumstances, a proposal to tax essential goods and services will merely accentuate a blight on our society. Indeed, it is difficult to see how we would even begin to consider support for taxing essentials in the absence of a concerted federal/provincial effort to improve minimum income protection for Canadians.

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Not only do considerations of fairness lead us to adopt perspectives that are different from those found in the White Paper, but so does our concern about openness in tax matters. Specifically, our concern about the visibility of taxes and tax burdens leads us to propose that the full indexation of tax brackets and the proposed credits be part of the tax reform package. In addition we believe that no matter what alternative to the existing Manufacturers Sales Tax is adopted, it must be visible to the consumers who are paying the bill.

We have also noted above that the burgeoning of selective tax measures has shielded from view the degree of government support that is provided in relation to various objectives. Thus we believe that openness requires a commitment to the regular publication of tax expenditure accounts, the distributional impact of tax expenditures, and an assessment of their effectiveness in meeting their stated objectives. Tax reform must include a commitment to this type of reporting on selective tax measures so that Canadians can form reasonable judgements on this important feature of our tax system.

We also want to note again our concern about the lack of accountability on the part of both the government and corporate taxpayers for how the selective C.I.T. measures are used. Thus we repeat, once again, our desire to see these measures replaced by direct grant programs that are tied to specific performance guarantees.

As far as the prospects for achieving simplicity are concerned, we would begin by noting that the prospects for achieving simplicity within the P.I.T. would be enhanced by treating employment and investment income equally. Further simplification could be achieved by looking beyond the tax system itself to see to what extent the social tax measures in the P.I.T. could be integrated into direct transfer programs. There should be room in this area for simplifying both the P.I.T. and the government's overall income support activities.

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Substantial scope for simplifying the C.I.T. lies in the area of replacing the existing selective tax measures with grant programs. As we have noted above, such a conversion has the virtue of increasing openness and accountability as well.

Finally, as far as sales taxes are concerned, it appears to us that the simplest option to the existing M.S.T. is a federal retail sales tax.

CONCLUDING REMARKS

When the Minister of Finance announced, in the summer of 1986, that comprehensive tax reform was part of the government's agenda, we at the C.L.C. -- like many other Canadians -- were pleased. It appeared to us that the opportunity had arrived to correct the unfairness of our tax system -- an unfairness that had become patently obvious to all who chose to look at the tax system. The fact that high income individuals and profitable corporations could pay no income taxes at all were the most grotesque symptoms of a tax system that had lost its sense of fairness.

Unfortunately, we should have paid more attention to the immediate provocation for the Finance Minister's conversion to tax reform -- namely tax reform in the United States. For what has been delivered in the White Paper is not a set of reform proposals guided by Canadians' concerns about fairness, openness, and simplicity. What has been delivered -- in both substance and process -- is a rushed attempt to make the Canadian tax system similar to the reformed U.S. system.

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Among the numerous proposals in the White Paper, we can find many individual proposals that we support. But when we stand back and look at the whole picture and realize that even the most grotesque manifestions of unfairness remain, we have to describe the package, as a whole, as totally inadequate. The government has relinquished the opportunity to make proposals that would turn the Canadian tax system into one guided by the central characteristics of fairness, openness and simplicity. Clearly the White Paper does not remove tax reform from a central place in our political agenda.

Respectfully submitted on behalf of the
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